THE BUSINESS OF MISSION

Mathew Josephs May 5, 2009
Deputy Director of Policy and Programs
CDFI Fund
U.S. Department of the Treasury
601 13th Street, NW, Suite 200 South
Washington, DC 20005

RE: Request for Comment on Capital Magnet Fund Program

Dear Mr. Josephs,

On behalf of Stewards of Affordable Housing for the Future (SAHF), I appreciate the opportunity to comment on the CDFI Fund's Request for Comments published in the ***Federal Register*** on March 6, 2009 regarding the Capital Magnet Fund Program (CMF).

Launched in 2003, SAHF has nine sophisticated not-for-profit members who acquire, preserve and are committed to long-term, sustainable ownership and continued affordability of multifamily rental properties for low-income families, seniors, and disabled individuals. Together, SAHF members own and operate housing in 50 states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands—providing homes to approximately 90,000 low-income households. SAHF's comments draw on the expertise of its nine not-for-profit members who have decades of experience in providing affordable housing to some of the Nation's lowest income individuals and families.

Since the introduction of a comprehensive federal housing program with the 1937 Housing Act, the federal government has implemented many programs to help house low- and very-low income residents under both housing and tax statutes. Many programs have matured and faded over time, while others continue to provide invaluable support for the production of affordable housing, first among them the Low-Income Housing Tax Credit and project-based Section 8 programs. The strength of the United States rests on its ability to house its lowest-income residents in well-built, sustainable environments. Therefore, we take great pleasure in providing comments on how to create a strong, flexible and successful Capital Magnet Fund.

Given that the Capital Magnet Fund is to be leveraged on a 10 to 1 ratio, it is important that the Fund remain open and flexible and not unduly burdened with an additional layer of restrictions and/or regulations that would impede projects from coming to fruition.

Further, in light of the economic downturn and the loss of investors in the Low-Income Housing Tax Credit (LIHTC) market, SAHF proposes an additional means by which the CMF could assist in the production of affordable housing through a Public Benefit LIHTC Guaranteed Fund. This letter will describe how the CMF could support the LIHTC guaranteed funds as well provide SAHF's comments per the CDFI Fund's Request for Comments.

USE OF CAPITAL MAGNET FUND TO SUPPORT PUBLIC BENEFIT LIHTC GUARANTEED FUNDS

Background

The Low Income Housing Tax Credit market has matured since the early 90's when investors were scarce and yields were 15% or more in after-tax returns. With heavy demand from Fannie Mae and Freddie Mac and CRA-motivated banks, yields gradually declined and hit a low point in early 2006 with multi-investor fund yields at a 4.50% after-tax return. The credit crisis in 2007 and the following recession changed everything. Most reports have 2009 demand for new tax credit investments at about 1/3 the level of 2006. Freddie Mac and Fannie Mae, which once accounted for 40% of total demand, are out of the market. Many of the banks that invested for CRA benefit are also out of the market due to record losses resulting in lack of taxable income or investment capital. Pricing for 9% LIHTCs have dropped from 90 cents on the dollar to around 70 cents. The 4% syndication market is practically non-existent.

Another major change in the market is the almost complete collapse of the guaranteed tax credit market. Historically, about 25% of tax credit investments were sold with the investment return guaranteed by an AA or AAA credit. By mid-2008 almost all guarantors were out of the market; former guarantors include: AIG/SunAmerica, Morgan Stanley, Merrill Lynch, Citi Corp, GMAC, Ambac, AEGON and Wachovia.

Finally, another shift in the market is a move from multi-investor funds to proprietary single investor funds and direct investing. *The investors who have continued in the market with this investment strategy have very specific and narrow investing guidelines.*

The limited demand in what remains of the current tax credit market is focused on plain-vanilla transactions, typically involving larger, to-be-constructed properties in large coastal MSAs targeting 60% area median incomes. Due to size and underwriting complexity, small preservation transactions, rural properties and projects serving special need populations are not attractive to the investors currently in the market.

Potential Use of Capital Magnet Funds to attract "creditworthy' guarantors.

Capital Magnet Funds could be used as a "top loss" cash reserve to attract traditional and non-traditional guarantors into the guaranteed LIHTC market. The top loss reserve would provide additional financial protection (in addition to project level and investment fund level reserves) to prospective guarantors that would enable these guarantors to *employ broader investment guidelines for projects*; thus allowing a guaranteed fund to include less desirable projects such as smaller preservation properties, HUD Section 202 projects for the elderly, special needs housing and rural properties. In addition, the investors in guaranteed funds are able to employ the "effective yield" method of accounting which makes investing in high tax loss, 4% tax credit transactions more desirable. Guaranteed funds could also be a good vehicle for "first time" investors to become familiar with this asset class.

Example: The exposure of a guarantor on a $50 million tax credit fund is approximately $110 million. A $5 to $10 million top loss reserve therefore could leverage a $100 million guarantee thus achieving leverage of at least 10/1 and up to 20/1. A non-profit syndicator could sponsor (serve as general partner of) the guaranteed fund and insure that the included projects met the policy objectives of the capital magnet legislation. The guarantor of this fund could be a traditional entity such as an insurance company or other financial institution as well as new sources of guarantees including pension funds or foundations. Project selection, fund structure and underwriting criteria could be developed to ensure that broader policy objectives are met and that the Capital Magnet Funds are invested in a financially responsible manner.

COMMENTS ON ANY POTENTIAL APPLICATION OF CAPITAL MAGNET FUNDS

At a time when homelessness is rising as a result of the economic downturn, income growth at the lower and middle levels has stagnated and poverty remains persistent, the Capital Magnet Fund is a timely innovation, as the need for quality affordable housing and strong communities remains high. SAHF recognizes that the CMF will not be *the* source to alleviate the persistent absence of affordable housing and community and economic development funds, but also acknowledges that a well designed Capital Magnet Fund can stimulate much-needed investment and innovation.

While SAHF believes that the use of Capital Magnet Funds to support public benefit LIHTC guaranteed funds would be the most effective use at this time, SAHF also understands that the most pressing needs will change from time to time. The program should be structured to encourage LIHTC guaranteed funds in the short term, with rules which can adapt readily to other high value innovative uses as the needs and opportunities arise. Due to the variety of existing federal, state and local funding programs available for the production of affordable housing, it is vital that the CMF program's policy goals are consistent with current broadly-applicable community development policies and that the CMF program's funding be compatible with existing financial tools, rather than adding an additional layer of regulatory complexity to be reconciled with the requirements of other funding sources. In light of these goals, SAHF offers the following suggestions in response to the Fund's specific questions.

Eligible Uses

Owing to the required leverage of the CMF (10 to 1), most non-profit affordable housing developers will use the fund for smaller, shorter term loans, as gap money or to cover the costs of up-front assessment and feasibility fees that can be paid back in a short period of time, rather than use the Fund for long-term financing. Therefore, it is important to keep the eligible uses broad and flexible. Non-profit affordable housing developers will most likely use the CMF grant at the parent entity level, which increases the ability to leverage the grant both initially and through the long-term revolving nature of the funds. Therefore the ability to use CMF funding for "risk-sharing" loans should be clarified to permit the grantee to use the funds as a source of guarantee or credit enhancement of project-level financing. Rather than impose additional or possibly conflicting income or other targeting on the development activity supported by the CMF funds, applicants should describe in their applications how their business plan will use CMF financial support to further their plans. The applicant's description of such plans—be it a business plan for an area or development or a strategy to invest in particular ways in various types of development plans—should be what determines whether the activities are in conjunction with affordable housing. Those terms should be defined with regard to the overall community strategies, not based on a pre-described, strict relationship between the uses.

Affordable housing developers may use the CMF grant fund to leverage the ability to preserve, purchase, rehabilitate, acquire for preservation or construct housing or related community and economic development activities, but the CMF alone, as an enterprise entity, should not dictate affordability use restrictions because the CMF is not a permanent source of capital in a project. While the CMF may inquire, as part of the competitive application process, how or whether long-term affordability is a part of a larger development plan, it should not independently set use restrictions requiring operating subsidies it cannot fund. Rather, the governing restrictions should be those of the programs that provide the majority source of funding for the project.

While SAHF supports the existing legal definition of "affordable housing," we do not want to create an unnecessary layer of regulation when the Capital Magnet Fund is designed to only support up to 10 percent of project financing. We therefore support definitions linked to whatever federal, state or local affordable housing program constitutes the majority of the funding for the project. That said, if a definition is needed, SAHF supports affordable housing defined as housing for families up to 120 percent of area median income or through a local index of housing cost burden to income through which families spend no more than 30 percent of income for an average area housing payment, whether rental or home ownership.

Affordable housing preservation should include restoration of deteriorated properties, creation of more responsive property management, and prevention of troubled properties from going into default, as well as refinancing of multi-family mortgages. This includes preserving "expiring-use properties" coming to the end of their HUD restrictions.[1] The transaction should materially reduce operating costs (including weatherization or other energy efficient modifications), extend the term of affordability, or extend the expected physical life of the property. We also suggest preserving housing by converting a market rate conventional apartment complex to an affordable complex by way of a refinancing of the conventional debt. This meets the intent of the Act in that it creates more units of affordable housing and thus should be included in the definition of affordable housing.

The definition of income levels should follow those used for extremely low-income and very low-income families per the definition used in the Affordable Housing Trust Fund. Low-income should be defined as families having incomes above 50 percent and up to 80 percent.

To prevent abuse, SAHF suggests that "primarily" for the purpose of measuring the Capital Magnet Fund leverage, be defined as follows: all non-Capital Magnet Fund financing sources[2]

[1] Primarily § 221(d) (3) BMIR, § 236, and § 202 properties.

[2] For the purpose of leverage and leverage reporting, non-Capital Magnet Fund financing sources should include both federal and non-federal sources of capital.

should be recognized for housing if at least 50 percent of the units are "affordable." If less than 50 percent of the units are affordable, then the leverage amount should be the cost of the affordable portion of the project minus the Capital Magnet Fund monies associated with it. Further, at least 20 percent of each housing project should be "affordable," consistent with the rules governing LIHTC and tax-exempt multifamily bonds. This definition should provide enough flexibility without creating an opportunity for abuse.

Eligible Grantees

Under the CMF statue, eligible grantees include both CDFIs and non-profit affordable housing providers—both should be judged in the application process on their respective experience in the development, acquisition, rehabilitation and/or purchase of affordable housing for community and economic development activities. As a non-profit organization needs to have "as one of its principal purposes" the development or management of affordable housing, this should not be read narrowly as an organization's sole or primary purpose. It could either be one of the named purposes of the organization in its by-laws or other controlling documents, or an activity that uses 20 percent or more of its time or resources.

Many affordable housing developers are involved in the provision of a wide range of care and services, where housing is just one of many components of their charter. For example, SAHF member Volunteers of America, a century-old institution, provides a vast range of services, affordable housing just being one of them, and not the predominant activity of the organization. In order to ensure that leaders of the affordable housing community like Volunteers of America are not excluded as eligible grantees, it is important to set the uses of activity at 20 percent.

Application

SAHF encourages the CDFI Fund to follow the language of the Capital Magnet Fund statute and fund initiatives that alleviate distress without being limited to low income census tracts. In other words, the CDFI Fund should not target activities only to low-income census tracts, nor use it as a form of measurement for alleviating poverty. Low-income persons are a "targeted population" in both the CDFI and NMTC programs. SAHF recommends that the Fund enable CMF grantees to similarly serve such populations regardless of location. The applicant should describe how its activities will serve to bring capital to affordable housing related developments or how its plan will address and/or improve existing conditions of economic distress.

Further, we believe that the CDFI Fund should support what the law clearly states, "economic development activities or community service facilities, such as day care centers, workforce development centers, and health care clinics, which *in conjunction with affordable housing activities* implement a concerted strategy to stabilize or revitalize a low-income area or underserved rural area." There should be no restrictions on the relative amount of community and/or economic development versus production of affordable housing. The application should permit an applicant to make its case with respect to a particular project.

As an example, one of the permitted uses of Capital Magnet Funds should be to finance health care service space built in conjunction with affordable housing. This space would allow seniors and others to be able to age in place, thereby lessening the need for people to be dislocated from their homes in order to obtain health services. These services could include meals programs, health care clinics, or Program for All-Inclusive Care for the Elderly (PACE) centers. The service site may or may not be physically a part of the affordable housing, but near it and built in conjunction with the acquisition or construction of the affordable housing.

We recommend that "in conjunction with" should be defined as facilities built or acquired at the same time and associated with the building or acquisition of affordable housing. Additionally, we propose that the use of funds be considered to create such service facilities after the fact, in order to enhance the quality of life of residents of existing affordable housing.
SAHF supports an annual competitive grant application.

Geographic Diversity

It is vital that the Fund collect data through the application process and grant award process regarding the location (metropolitan, rural, suburban and urban in every state) of the activities supported through CMF financing. While we acknowledge that it would be difficult to enforce fair distribution of awards for the first round of grants, we do advocate that data be kept and underserved areas be given attention, through training and/or technical assistance to potential applicants who might work in those areas should funding be made available.

Instead of creating a unique CMF definition for "economic distress", SAHF recommends that the Fund permit applicants to adhere to existing local, state or federal program definitions applicable to the activity being supported. With respect to defining rural areas, SAHF recommends using the USDA Rural Housing definition in Section 520 of the Housing Act of 1949.[3]

Finally, SAHF firmly believes that the strength of the CMF is in its ability to serve a range of income levels and areas, and that it should not be limited to geographic areas of economic distress since the priorities of the program are extremely low-, very low-, and low-income families. Therefore we want to ensure that the indicators do not limit the CMF grants only to areas experiencing blight and disinvestment. The same approach should be taken with income and joblessness. Here, business plans should not be limited to only areas with high unemployment; rather the grant applications should demonstrate how a specific project will serve low-income and/or unemployed people.

Thank you for the opportunity to comment. Please do not hesitate to contact me at 202-737-5975 or bkelly@sahfnet.org if you have questions or need additional clarification.

Sincerely,

William C. Kelly, Jr.
President

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[3] The term or "any rural area" is defined as any open country, or any place, town, village or city which is not part of or associated with an urban area and which has 1) a population not in excess of 2,500 inhabitants, or 2) a population in excess of 2,500 but not in excess of 10,000 if it is rural in character, or 3) a population in excess of 10,000 but not in excess of 20,000 and is not contained with a standard metropolitan statistical area and 4) median family income does not exceed 85% of statewide median income.